



## **COMPTROLLER OF THE TREASURY OF MARYLAND v. WYNNE**

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### **TAXING BUSINESS INCOME AS PERSONAL INCOME**

*Maryland State Comptroller v. Wynne* involves taxes business owners or investors pay on the income they receive from the business. The business generating the income is referred to as an "S Corporation" or "S Corp," a federal IRS designation that allows businesses to pass their income, losses, deductions, and credits on to their shareholders and thus avoid having the income taxed twice—as business income and personal income.

People who have an ownership interest in an S Corp that does business in several states may have to pay taxes to their home state and each state in which the S Corp operates. Many home states provide a credit against income taxes paid to the other states. *Wynne* arose because Maryland counties do not provide such credits.

businesses.

### **ISSUE**

What is at stake for Connecticut and other states in *Maryland State Comptroller of the Treasury v. Brian Wynne, et ux (Wynne)*, which is pending before the U.S. Supreme Court (Docket No. 13-485)?

### **SUMMARY**

The stakes for Connecticut and other states in *Wynne* outcome depend on several factors, including the state's income tax structure and the rationale for the Court's decision. A decision in the Wynnes' favor would not immediately affect Connecticut. A decision in Maryland's favor would affect Connecticut and other states depending on the Court's reasoning.

Maryland residents Brian and Karen Wynne claimed a credit against their county income taxes for taxes paid to other states on income generated there. Maryland authorizes no such credit against the county income tax although it authorizes one against the state income tax. In a series of appeals, the Wynnes argued that the county tax violated the U.S. Constitution's Commerce Clause by taxing the income they derived from an out-of-state business at a higher rate than it taxed the income other residents derive from in-state

It appears that a decision overturning Maryland's county income tax would affect states that do not provide an income tax credit against state, county, or municipal income taxes for taxes paid on income generated in other states. Connecticut does not fall in this category because it offers such an income tax credit, has no county governments, and authorizes no local income taxes.

Whichever way the Court decides, the decision could have other consequences. A decision upholding the Maryland tax could provide a legal basis for states to reduce or eliminate credits for taxpayers who pay income taxes to other states on income generated there. A decision overturning the tax could require state courts to adjust state tax structures that affect activity taxed by several states. Such a decision could also allow residents of a state or its political subdivisions to pay less in income tax than residents who derive all their income from activity within the jurisdiction.

## **BACKGROUND**

In 2006, Maryland's comptroller assessed Brian and Karen Wynne for underpaying income taxes owed Howard County, where they live. The assessment concerned the income the Wynnes received from their ownership interest in an S Corporation that operated in several states. S Corporations pass their profits through to their owners, which subjects them to federal and state personal income taxes.

Because the corporation operated in several states, it allocated each owner a pro rata share of the income taxes due each of these state. The Wynnes reported all of this income on their 2006 Maryland return, but claimed a credit against their county income tax for the income taxes they already paid to other states on the income generated in those states. Under the law, though, they could claim that credit against only their state income tax ([Md. Code TG § 10-703 \(c\)](#)). Consequently, the comptroller recomputed the county tax and assessed the Wynnes for the resulting deficiency.

The assessment triggered a series of appeals, culminating in 2011, when the Maryland Court of Special Appeals overturned the assessment. The comptroller subsequently appealed that decision to the U.S. Supreme Court.

## **DOES MARYLAND'S INCOME TAX VIOLATE THE COMMERCE CLAUSE?**

### ***Commerce Clause***

The issue before the Court is whether Maryland's income tax violates the U.S. Constitution's Commerce Clause, which authorizes Congress to regulate interstate trade. The U.S. Supreme Court has interpreted the Clause as granting Congress the

power to prevent states from enacting laws inhibiting the flow of goods across state lines. Consequently, the Court has decided many cases involving state laws affecting interstate commerce, and legal scholars cite those cases as evidence of a “dormant Commerce Clause doctrine.”

### ***County Income Tax***

The Wynnes argued that Maryland violated the Commerce Clause by allowing counties to tax all of the personal income residents derived from business activities conducted in other states regardless of any personal income taxes paid to those states. Maryland provided no credit that would have allowed these residents to reduce their county income taxes based on the taxes paid to other the states. (On the other hand, the state did allow such a credit against the state income tax.) Consequently, the residents paid income taxes at a higher rate than Maryland taxpayers who derived all of their income from activity in Maryland alone.

According to the Maryland Court of Appeals, Maryland violated the Commerce Clause by creating

a disincentive for the taxpayer—or the S corporation of which the taxpayer is an owner—to conduct income-generating activities in other states with income taxes. Thus, the operation of the credit with respect to the county tax may affect interstate markets for capital and business investment and, accordingly, implicate the dormant Commerce Clause ([\*Maryland Comptroller of the Treasury v. Brian Wynne, et ux\*, 431 Md. 147](#)).

The Supreme Court must decide whether Maryland’s county income tax violated the Commerce Clause.

### **THE STAKES FOR CONNECTICUT**

It appears that Connecticut will not have to change its income tax structure regardless of how the Supreme Court rules in *Wynne*. But the reasons the Court gives for upholding or overturning Maryland’s county income tax could affect future state tax policy, according to several briefs filed with the Court.

### ***If the Court Rules in Favor of Maryland***

Connecticut would not have to change its income tax structure if the Court were to affirm the right of Maryland counties to tax personal income from activities in other states without providing a credit for the income taxes paid to those states. The

decision though, could provide the legal grounds for Connecticut and other states to reduce or eliminate similar credits if the Court specifically decides that the Commerce Clause does not affect state tax policy.

Such a decision could also set the stage for Congressional action. The Wynnes argued that Maryland's failure to provide a credit for the taxes paid on business income generated in other states violated the dormant Commerce Clause. But Justices Scalia and Thomas have previously rejected the idea of a dormant Commerce Clause. Consequently, the court could use the case to "eliminate or significantly curtail dormant commerce clause jurisprudence," *Forbes'* Cara Griffith [wrote](#). Arguably, such an outcome could put pressure on Congress to address state tax policies taxpayers believe interfere with interstate commerce.

### ***If the Court Rules in Favor of the Wynnes***

***No Immediate Consequences for Connecticut.*** A decision requiring Maryland counties to grant residents credits for income taxes paid to other states would not affect Connecticut's income tax because Connecticut has no county governments and does not authorize municipal income taxes. Furthermore, Connecticut, like Maryland, provides a state income credit for income taxes residents paid to other states ([CGS § 12-704](#)).

***Judicial Review of State Tax Policies.*** A decision requiring Maryland to grant a credit against the county income tax for income taxes paid to other states could force state courts to engage "in a never-ending task of determining whether particular taxes imposed on an individual as a resident should be reduced or eliminated because another state or local government also has jurisdiction to impose a tax on the individual as a nonresident," the [Multistate Tax Commission stated](#) (Brief of *Multistate Tax Commission as Amicus Curiae in Support of Petitioner Maryland State Comptroller of the Treasury*, August 5, 2014). (The 47-state commission attempts to promote uniformity in state tax laws.)

Consequently, "analyzing the interplay of many potentially conflicting state and local government tax systems to determine whether a credit is mandated would require the courts to make legislative value judgments, and could ultimately undermine our system of federalism by limiting state tax policy and choices and revenues," the brief stated.

Maryland's attorney general argued that such an outcome would require the courts to devise judicial solutions to inherently political problems. "If Maryland residents think that the State is taxing them too onerously, they can give direct effect to their views by voting various forms of lower taxes, including more generous credits for

out-of-state tax payments. After all, state legislators are hardly impervious to voters' opinions about high taxes," the attorney general [stated](#) (*Maryland State Comptroller v. Brian Wynne, et ux on Writ of Certiorari to the Court of Appeals of Maryland*, July 2014).

**Potential Fiscal Consequences.** A decision overturning the county tax could have fiscal consequences for counties and municipalities that do not provide credits against income taxes residents paid to other states. "By compelling Maryland to give a full credit for tax payments to other states—that is, a credit that could be applied against the County tax as well as the State tax—the lower court's ruling would have the perverse effect of allowing certain taxpayers to enjoy all the benefits available to Maryland residents without contributing any income taxes in return," Maryland's attorney general wrote.

## HYPERLINKS

Md. Code TG § 10-703(c):

<http://mgaleg.maryland.gov/webmga/frmStatutesText.aspx?article=gtg&section=10-703&ext=html&session=2014RS&tab=subject5>, last visited on October 30, 2014

*Maryland Comptroller of the Treasury v. Brian Wynne, et ux*, 431 Md. 147:

<http://www.mdcourts.gov/opinions/coa/2013/107a11.pdf>, last visited on October 30, 2014

Cara Griffith, "Are Credits for Taxes Paid to Other States Doomed?," *Forbes*, August 29, 2014: <http://www.forbes.com/sites/taxanalysts/2014/08/29/are-credits-for-taxes-paid-to-other-states-doomed/>, last visited on October 30, 2014

CGS § 12-704: [http://www.cga.ct.gov/2013/pub/chap\\_229.htm#sec\\_12-704](http://www.cga.ct.gov/2013/pub/chap_229.htm#sec_12-704), last visited on October 30, 2014

Multistate Tax Commission: <http://www.mtc.gov/>, last visited on October 30, 2014

*Multistate Tax Commission as Amicus Curiae in Support of Petitioner Maryland State Comptroller of the Treasury*, August 5, 2014:

[http://www.americanbar.org/content/dam/aba/publications/supreme\\_court\\_previews/BriefsV4/13-485\\_pet\\_amcu\\_mtc.authcheckdam.pdf](http://www.americanbar.org/content/dam/aba/publications/supreme_court_previews/BriefsV4/13-485_pet_amcu_mtc.authcheckdam.pdf), last visited on October 30, 2014

*Maryland State Comptroller v. Brian Wynne, et ux on Writ of Certiorari to the Court of Appeals of Maryland*, July 2014:

[http://www.americanbar.org/content/dam/aba/publications/supreme\\_court\\_preview/BriefsV4/13-485\\_pet.authcheckdam.pdf](http://www.americanbar.org/content/dam/aba/publications/supreme_court_preview/BriefsV4/13-485_pet.authcheckdam.pdf), last visited on October 30, 2014

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